INDEPENDENT AGENCIES: GOVERNMENT'S SCOURGE OR SALVATION?

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This symposium invites reflection on a number of important questions concerning the independence of the independent regulatory agencies. Three such questions are briefly examined in this essay: First, what is the nature of an independent agency? Second, why should regulatory agencies be independent? Finally, what constrains, and what ought to constrain, an agency's independence? These questions are considered against the backdrop of the legal debate about the constitutional legitimacy of independent regulatory agencies that has been raging since Congress created the first such agency a hundred years ago. The thoughts and conclusions offered in this essay draw on the history and recent experience of the United States Securities and Exchange Commission ("SEC" or "the Commission"), long recognized as one of the finest independent agencies.

I. WHAT IS AN INDEPENDENT REGULATORY AGENCY?

An independent regulatory agency is a government entity that frequently exercises executive, judicial and legislative power over a specifically defined area of government interest. In a word, independent agencies are the fourth branch of government, operating separately from but under the oversight or review of the other three. The SEC is a prime example of such an agency.

The SEC was established by Congress in 1934. Its enabling legislation is the Securities Exchange Act of 1934 (the 1934 Act). That Act[1] provides that the Commission be composed of five commissioners (including a Chairman) appointed by the President with the advice and consent of the Senate. The commissioners are appointed for fixed terms of five years. They can be removed from office by the President only for good cause, and cannot be removed by the Congress except through the drastic method of impeachment by the House of Representatives and

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1. 15 U.S.C.A. § 78d (West Supp. 1988).

trial by the Senate. As a result of this structure, the commissioners (like the heads of other independent agencies) are somewhat shielded from the vagaries of shifting political opinion. In addition, the 1934 Act does not allow more than three of the five commissioners to be members of the same political party.

The Commission does not operate under the specific direction of the judicial, legislative or executive branches of government. For example, the Commission is empowered to sue in its own name to enjoin violations of the securities laws and to seek other equitable relief without the approval of the Department of Justice.[2] Moreover, the Commission can formulate policy for the government by exercising its authority to adopt rules that implement the objectives of the federal securities laws. These rules have the same legal force as statutes and are promulgated without prior approval from Congress. Under certain circumstances, the Commission is also authorized to conduct quasi-judicial proceedings to sanction individuals and entities for violating provisions of the securities laws.[3] As when it initiates court actions, the Commission can perform this quasi-judicial function without the advice or approval of either the executive or legislative branch.

The SEC also may recommend and comment on legislation without consulting with the executive branch or other agencies. Indeed, Congress has specifically provided that the Commission cannot be required to submit legislative recommendations, testimony, or comments on legislation to any office or agency of the government for review before it submits them to Congress, as long as the views submitted are identified as the Commission's and not the administration's.[4] Of course, as a matter of prudence and courtesy the Commission does consult with other agencies of government in formulating major legislative positions. A recent example of the Commission drafting and obtaining the passage of major legislation on its own initiative is the Insider Trading Sanctions Act of 1984, which penalizes persons who unlawfully trade in securities while possessing material, nonpublic information. The penalties can be as high as three times the gain obtained or loss avoided.[5]

Notwithstanding their independence, regulatory agencies are subject to influence from the legislative and executive branches. The President,

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2. A limited exception involves appeals to the United States Supreme Court, where the concurrence of the Solicitor General normally must be obtained.

3. In general the Commission may institute administrative proceedings against regulated entities or persons (e.g., broker/dealers) for violating the securities laws or against any person for violating or causing violations of certain provisions. *See* Securities Exchange Act § 15(c)(4), 15 U.S.C. § 78*o*(c)(4) (Supp. IV 1986).

4. 12 U.S.C. § 250 (1982).

5. Pub. L. No. 98-376, 98 Stat. 1264 (codified at 15 U.S.C. § 78u(2)(A) (Supp. IV 1986)).

for example, has significant influence over the SEC through his power of appointment. In particular, he is able to substantively affect the policy direction of the agency by appointing commissioners who share his philosophy. Of special importance is the power to appoint the Commission's Chairman. The Chairman, who serves in that capacity at the President's pleasure,[6] has primary responsibility for the management of the Commission, and thus significantly influences its policies, particularly through the general control of the Commission's calendar and the use and expenditure of its funds. However, since the Commission may act only by the majority vote of its members, individual commissioners can also influence the Commission's orientation, agenda and special projects.

By using his power of appointment, President Reagan has proven able to influence the direction of the SEC. As a result, the SEC has successfully completed a number of deregulatory initiatives, most of which have been salutary, during the past seven years. For example, the Commission has integrated and streamlined the disclosure system of the federal securities laws.[7] This major revision of the Commission's regulations has increased corporations' financing flexibility and reduced their expenses by well over $350 million per annum,[8] while reducing the Commission's paperwork. At the same time, these changes were designed to maintain a system of adequate and timely disclosure of material information to the investing public. In another initiative, the Commission has freed up over $700 million of the securities industry's capital by updating the SEC's net capital requirements for broker/dealers and by permitting the use of letters of credit for clearinghouse deposits and stock loan collateral.[9] The Commission has also eased its regulations governing financing of small businesses, including the adoption and subsequent expansion of Regulation D, which exempts certain securities offerings from registration.[10]

The Senate, of course, influences the Commission through the confirmation process, in which the Senate can exact promises from nominee commissioners or even reject their nominations.

While the independence of regulatory agencies yields many advantages, it can present problems as well. One problem area is the resolution

6. Upon a change in administration, the Chairman of the SEC is expected to tender his resignation to the new President. However, neither he nor the other commissioners are required to resign their posts.

7. *See, e.g.*, Securities Act Release No. 6499, 48 Fed. Reg. 52,889 (1983); Securities Act Release No. 6383, 47 Fed. Reg. 11,380 (1982).

8. SEC, FIFTY YEARS OF THE U.S. SECURITIES AND EXCHANGE COMMISSION 74 (1984).

9. *See, e.g.*, Exchange Act Release Nos. 34-18,417 to 34-18,420, 47 Fed. Reg. 3512 (1982); Exchange Act Release No. 34-18,377, 47 Fed. Reg. 21,759 (1982).

10. SEC, *supra* note 8, at 75; Securities Act Release No. 33-6389, 47 Fed. Reg. 11,251 (1982).

of interagency disputes. When two departments of the executive branch are in conflict, the President provides a resolution by simply choosing one course of action over another. However, when independent agencies disagree, there may be no simple means of reconciling their differences; this increases the probability of unseemly interagency squabbles. Even when agencies negotiate and resolve their disputes through negotiation, legislation or judicial action may be necessary to effect the agencies' compromise agreements.

The potential scope and complexity of interagency disputes are demonstrated by the controversy surrounding the question of regulatory jurisdiction over new financial products. The development of products such as futures on currency and options and futures on stock indexes provoked vigorous and heated debates between the SEC and the Commodity Futures Trading Commission (CFTC) about who should regulate these new products. Efforts to resolve these issues resulted in a 1982 SEC/CFTC accord. However, in order for the accord to have any effect, Congress had to enact implementing legislation.[11]

Notwithstanding the SEC's correctly held position that futures on stock indexes were securities subject to its jurisdiction, the compromise struck in the SEC/CFTC accord gave jurisdiction to the CFTC. That compromise, while clearly justifiable at the time, proved to be improvident. Today, the SEC and the CFTC are facing the same, but exacerbated, jurisdictional issues. The October 1987 market break demonstrated that the market for stock index futures and the market for equities have become linked, so that transactions in one have a direct effect on the other.[12] Thus, the market break highlighted the need for consolidating regulatory authority over futures on stock indexes with that over the other securities markets. Yet the SEC, the agency statutorily responsible for regulating securities markets, lacks the power to resolve this problem on its own because of its status as an independent agency. Congressional action, difficult to accomplish in the best of times on less controversial matters, is necessary to effect consolidation.[13]

11. The accord was enacted in the Securities Act Amendments of 1982, Pub. L. No. 97-303, 96 Stat. 1409 (codified at 15 U.S.C.A. §§ 77b, 78c(10), 78i, 78bb(a), 78*lll*(14), 80a-2(a)(36), 80b-2(13) (West Supp. 1988)), and The Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (1983) (codifed as amended in scattered sections of 7 U.S.C.).

12. SEC Recommendations Regarding the October 1987 Market Break 5 (1988), *reprinted in "Black Monday," The Stock Market Crash of October 19, 1987: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs,* 100th Cong., 2d Sess. 141, 144 (1988) (testimony of David S. Ruder, Feb. 3, 1988).

13. Letter from Chairman of SEC to President of Senate (July 7, 1988) (SEC's proposed amendments to the federal securities laws and the Commodity Exchange Act), *summarized in SEC Submits Legislative Proposal to Expand Oversight of Margin Setting,* 20 Sec. Reg. & L. Rep. (BNA) No. 28, at 1096 (July 15, 1988).

Pending congressional action, the regulatory scheme governing these markets creates potential harm for the markets and investors.

II. Why is Independence Important for Regulatory Agencies?

The simplest answer to the question why regulatory agencies exercising executive power are independent of the executive branch is that Congress so ordained it. Beyond that, however, it is instructive to ask why Congress chose to entrust the administration of numerous laws to independent agencies rather than to an executive office. The answer to this question probably lies in the historical growth and development of government as the society it governed became more diverse and complex. Where an agency is created to effectuate Congressional policy on complicated issues in accord with legislative standards, " 'Congress [does] not wish to have hang over the . . . [agency] the Damocles' sword of removal by the President for no reason other than that he preferred to have on that Commission men of his own choosing.' "[14]

Congress has resorted to the device of an independent regulatory agency on innumerable occasions during the past century when it has been faced with the need to regulate developing areas of national interest. Since the first regulatory agency, the Interstate Commerce Commission, was created in 1887, legal scholars have argued that independent agencies are unconstitutional because they violate the separation of powers doctrine and constitute an unlawful delegation of executive power. These scholars argue that the Constitution strictly limits how governmental power may be exercised and who may exercise it, thus creating a government of carefully separated powers deemed necessary for the preservation of "a strong government of free people." Independent agencies are viewed by these commentators as undermining the "original structural design that is, in the final analysis, the bedrock of our liberties."[15]

When it comes to justifying the independence of regulatory agencies against such arguments, historical and philosophical arguments must be tempered by pragmatism. Observation confirms that different administrations have different philosophies on how this nation should run. As a consequence, a reversal of public policy, especially in such areas as social welfare, education and foreign policy, often accompanies a change in administration. Apparently, Congress was in 1887, and is today, of the view that abrupt reversals in policy would be unfortunately disruptive if they

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14. Morrison v. Olson, 108 S. Ct. 2597, 2617 (1988) (quoting Wiener v. United States, 357 U.S. 349, 356 (1958)).

15. Olson, *Separation of Powers Principle is No "Triviality"*, Legal Times, July 21, 1986, at 4, col. 1.

were to affect commerce, communications and the capital markets—the life's blood of our economy. Therefore, it created agencies independent of the Executive, and thus free from the "coercive influence"[16] of serving at the President's will, to administer the laws governing these areas.

The SEC's independence is justified by its mandate from Congress, to ensure the fairness and integrity of the markets and to protect investors. The SEC administers a range of statutes regulating the capital-raising process, the secondary trading markets, financial intermediaries, collective investment vehicles and public utility holding companies.[17] These statutes are complex and require the high degree of technical expertise that is readily acquired and maintained by an independent agency. Indeed, technical knowledge and expertise were viewed as so critical to effective regulation of the securities markets that Congress specifically provided for significant self-governance by the securities industry in regulating those markets.[18] By entrusting much of the regulation of the markets to self-regulatory organizations such as the exchanges and the National Association of Securities Dealers, Congress further underscored the need to insulate securities regulation from the vagaries of the political process. Moreover, the SEC is required by statute to cooperate with and oversee these self-regulatory organizations in order to fulfill its statutory mandate. Thus, the SEC's independence is essential to the effective implementation of the statutory scheme.

Furthermore, the Commission is not solely a regulatory agency, but is also a law enforcement agency. In addition to being able to institute administrative proceedings, the Commission has statutory authority to prosecute violations of the federal securities laws through civil actions in federal district court. The Commission's discretion to prosecute is without leave and free from control by the legislative and executive branches. The recent enforcement proceedings brought by the Commission highlight the importance of this independence. For example, the Commission has not shied away from investigating and prosecuting a number of persons of power and rank. For example, in 1984 the SEC sued J. Lynn Helms, the chairman of the Federal Aviation Administration, charging him with fraud in the sale of industrial bonds. Mr. Helms consented to

16. *Morrison*, 108 S. Ct. at 2617.

17. The securities laws are the Securities Act of 1933, 15 U.S.C.A. §§ 77a-77aa (West 1981 & West Supp. 1988); the Securities Exchange Act of 1934, *id.* §§ 78a-78*ll*; the Public Utility Holding Company Act of 1935, *id.* §§ 79 to 79z-6; the Trust Indenture Act of 1939, *id.* §§ 77aaa-77bbbb; the Investment Advisers Act of 1940, *id.* §§ 80b-1 to 80b-21; the Investment Company Act of 1940, *id.* §§ 80a-1 to 80a-64; and the Securities Investor Protection Act of 1970, *id.* §§ 78aaa-78*lll*. The Commission has responsibilities under other statutes as well.

18. *See, e.g.*, Securities Exchange Act §§ 6, 15A, 15 U.S.C.A. §§ 78f, 78*o*-3 (West 1981 & West Supp. 1988).

the entry of an injunction without admitting or denying the SEC's allegations.[19] In 1985, the SEC also successfully concluded litigation with Paul Thayer, then the Deputy Secretary of Defense, alleging that he and certain of his associates had engaged in insider trading.[20] Earlier, in an equally well-publicized case, the SEC sued T. Bertram Lance, director of the Office of Management and Budget under President Carter, alleging securities fraud and other violations. Mr. Lance consented to the entry of an injunction against future violations.[21]

In the absence of the "coercive influence" of the President's unlimited power to terminate, the Commission has been free to enforce the law against the powerful and well-connected. There have been a number of attacks on the authority of independent agencies to enforce the law that could have precluded such successes. Some have argued that agencies such as the SEC are constitutionally infirm because Congress's delegation of executive power to government officials who do not serve at the pleasure of the President violates the separation of powers doctrine and impermissibly interferes with the functions of the executive branch. The Supreme Court's decision in *Morrison v. Olson*[22] hopefully has laid such arguments to rest. The case unequivocally rejects the separation of powers argument, continuing the Court's tradition of flexibly interpreting that doctrine.

The most important factor justifying the independence of the SEC from a particular political or economic ideology relates to the nature of the securities markets themselves. The markets in this country reflect the collective judgments of millions of investors, ranging from sophisticated institutions investing millions of dollars to individuals seeking to maximize their comparatively small, but nonetheless important, savings. Rules or legislation tied to a particular political ideology and designed to have particular economic effect are by no means assured of success. Indeed, it is virtually axiomatic that the market will try to overcome *any* cabining regulation. However, it is also true that judicious regulatory restraint is occasionally necessary to preserve the markets' fairness and integrity. An independent agency seems to be the best way to achieve a reasonable balance between the two concepts, viz., free but fair markets. Indeed, with the increasing complexity of our personal and commercial lives, the independent agency may be the only effective means of estab-

19. SEC v. Ascenzi Litigation, Release No. 10,541 (Sept. 25, 1984).

20. SEC v. Thayer Litigation, Release No. 10,746, slip op. (N.D. Tex. May 7, 1985).

21. SEC v. The National Bank of Georgia Litigation, Release No. 8395 [1978-79 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,402 (May 3, 1978).

22. 108 S. Ct. 2597 (1988).

lishing governmental control. Although imperfect, such agencies are certainly more of a salvation than a scourge.

III. What Constrains the SEC's Independence?

To say that the Commission is an independent agency is not to say that it operates or should operate without congressional or executive control. Part I of this essay points out the significant influence that Congress and the President have over regulatory agencies through the appointment and confirmation process. Both the legislative and executive branches have other, less direct but potentially effective means to restrain the activities and to shape the policies of independent agencies. The formation of the President's Working Group on Financial Markets (the Working Group) is a good example of the indirect but significant impact that the Chief Executive can have on an agency's momentum and direction.

The Working Group was formed in March 1988 by President Reagan, shortly after the Brady Commission and the SEC filed their respective reports on the October 1987 market break. The reports suggested several possible regulatory initiatives in response to problems uncovered by the break. These recommendations found little favor with the administration. As the SEC was poised to formulate proposed legislation, the President issued an executive order appointing George Gould, Under Secretary, Department of the Treasury; Wendy Gramm, Chairman of the CFTC; Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, and David Ruder, Chairman of the SEC, as members of the Working Group. The order enjoined the SEC from taking independent action with respect to the market break prior to reporting the Working Group's conclusions to the President in sixty days. As a result, submission of the Commission's legislative package was delayed until late June 1988, just a few weeks before Congress recessed.

The courts, too, play a particularly important oversight role with respect to the Commission's actions. Final actions of the Commission are subject to judicial review pursuant to the federal securities laws, the Administrative Procedure Act and other statutes. This oversight authority, which applies to rules promulgated by the Commission as well as to its adjudications in administrative proceedings, significantly restrained a recent Commission rulemaking initiative.

In 1985, the Commission promulgated Rule 3b-9,[23] which sought to regulate the securities activities of bank subsidiaries despite the exclusion of banks from the definition of "brokers" and "dealers" in the 1934 Act.

23. 17 C.F.R. § 240.3b-9 (1988).

The Commission attempted to accomplish this by defining the term "bank" in the statutory exclusion as not including a bank that received transaction-related compensation for certain brokerage activities. The rule was promulgated in response to the bank regulators' relaxation of their rules limiting bank involvement in the broker/dealer business. The United States Court of Appeals for the District of Columbia Circuit concluded that the Commission had exceeded its authority in adopting "Rule 3b-9 . . . , stating that whatever its beneficial purpose or the regulatory need for such authority, the rule still represented an attempt by one federal agency to reallocate, on its own initiative, the regulatory responsibilities Congress has purposefully divided among several different agencies."[24] The Court declared the rule invalid.

Congress also exerts significant indirect influence over independent agencies. For example, despite the fact that for the last several years the SEC has collected more money in fees than it spends, the Commission, like most agencies, depends entirely on funds authorized and appropriated by Congress for its operations. The budget process provides a powerful means of control. It is neither unusual nor inappropriate for Congress to use the budget process to ensure that an agency is fulfilling its statutory mandate. However, congressional committees have occasionally used or tried to use the budget process to prohibit or derail specific actions or programs for political rather than policy reasons with inappropriate and unfortunate results.

The Commission's "EDGAR"[25] project is one example. That project is intended to permit companies to make statutorily required filings with the Commission electronically by computer rather than in hard copy. It will also allow the Commission's staff and other users to obtain instantaneous access to the reported data by computer. This is a mammoth undertaking and its progress has not been without technical and logistical difficulties. Unfortunately, the project has been plagued by political difficulties as well. As a result, one of the Commission's oversight committees in Congress has imposed significant restrictions on the Commission's ability to finance the system. The current authorization act[26] for the SEC restricts expenditures on EDGAR for the next two years and imposes time-consuming reporting and certification requirements at six-month intervals.

24. American Bankers Ass'n v. SEC, 804 F.2d 739, 755 (D.C. Cir. 1986). The court recognized that the Commission was attempting to implement "functional regulation," a concept endorsed by the Bush Task Group on Regulation of Financial Services.

25. "EDGAR" stands for Electronic Data Gathering, Analysis and Retrieval.

26. Securities and Exchange Commission Authorization Act of 1987, Pub. L. No. 100-181, 101 Stat. 1249 (codified in scattered sections of 15 U.S.C.A.).

On July 9, 1987, the Senate Committee on Banking, Housing and Urban Affairs issued a report on legislation authorizing funds for the SEC for 1988-89.[27] This report provides a more pointed example of Congress's occasional effort to "micro-manage" the SEC. The report strongly criticized SEC staff economists and their studies, and threatened to prohibit use of appropriated funds for SEC economic studies if the Commission did not adopt the so-called "peer review" procedures recommended by the subcommittee. Apparently, some members of the committee disagreed with the analysis and findings of the Commission's studies. The Commission opposed the restrictive provision; it fortunately was not enacted.

Clearly, there is a legitimate need for congressional oversight of federal regulatory agencies. Such agencies operate under legislative mandates; therefore, it is appropriate that Congress monitor their activities. However, in recent years, at least in the case of the SEC, the agency has been subjected to the conflicting demands of a number of committees seeking to influence it. This can create an atmosphere of intimidation and uncertainty that ultimately may delay or completely forestall regulatory action. A recent congressional effort to restrain through intimidation has been to pressure the SEC in connection with its proposed Rule 19(c)(4), adopted on July 7, 1988.[28] Before adopting that Rule, the Commission was subjected to demands for swift and decisive regulatory action from members of the House Committee on Energy and Commerce, as well as demands from members of the Senate Committee on Banking, Housing and Urban Affairs, that it not adopt Rule 19(c)(4) until the agency conducted extensive studies of the need for and potential impact of the proposed Rule.

Although probably unintentionally in most cases, Congress also has inhibited the Commission's momentum by inundating it with a nearly overwhelming number of requests for information on a wide range of topics. A large percentage of an SEC Chairman's time is spent dealing with congressional matters. In 1987, members of the Commission and its staff testified twenty-seven times before various committees and subcommittees of Congress. In addition to testimony and other congressional liaison activities relating to legislation affecting the Commission or the securities laws, congressmen and their staffs made innumerable requests for information, documents and briefings on specific items or cases.

This degree of monitoring does not come without cost. Resources devoted to explaining the Commission's activities are necessarily diverted

27. S. REP. No. 105, 100th Cong., 1st Sess. (1987).

28. Exchange Act Release No. 34-25,891, 53 Fed. Reg. 26,376 (1988).

from the agency's regulatory and law enforcement responsibilities. Where these oversight activities are repetitious or focus unduly on specific as opposed to policy matters, the cost is unwarranted. Congress can minimize such costs without abrogating its oversight responsibilities and prerogatives if it relies primarily on testimony before committees and subcommittees on matters of policy concern. Congress should not have to routinely request information on specific matters without generalized importance in order to oversee agency activities. It is particularly disruptive when members of Congress disclose nonpublic, highly sensitive information obtained as a result of these reports and briefings.

CONCLUSION

Independent regulatory agencies have been called "peculiar creations." Indeed they are. For all their imperfections, they are peculiarly well-structured to adapt to changing human affairs and thus assist our democratic form of government to endure from generation to generation. As the recent market crash demonstrated, the Commission's responsibility to regulate the securities markets is of critical importance to the economic well-being of our nation. An independent SEC will help ensure the proper response to the changing conditions in tomorrow's markets, just as it has contributed to the development of the U.S. securities markets as they exist today.